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IN THE

Supreme Court of the United States

October Term, 1941.

No. 516.

GEORGE H. WHITELEY, JR.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit and Brief in Support Thereof.

FREDERICK H. SPOTTS,
Attorney for Petitioner.

ROBERT C. FLUHRER,
PEPPER, BODINE, STOKES & SCHOCH,
Of Counsel.

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COMMISSIONER OF INTERNAL REVENUE,
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PETITION FOR WRIT OF CERTIORARI.

To the Honorable, the Justices of the Supreme Court of the United States:

The Petition of George H. Whiteley, Jr., respectfully represents:

This is a petition for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit to review a decision affirming a decree of the Board of Tax Appeals. The case presented to the Board and the Court below involved two issues, wholly unrelated. This petition is limited to the questions raised by the Second Issue only, described in the Opinion below as "Trusts for Minor Children."

Summary Statement of Matter Involved.

All of the facts were stipulated and read as follows:

"1. Under date of June 12, 1935, George H. Whiteley, Jr., executed four trusts wherein The First National Bank of York was Trustee—one for the benefit

of each of his four children, George H. Whiteley, III, Morgan S. Whiteley, Purdon B. Whiteley and Virginia Whiteley. A true and correct copy of one of the aforesaid deeds of trust is introduced in evidence. The other trusts are identical.

"2. The total income of all four trusts for the calendar year 1935 was $5,878.00.

"3. Of the aforementioned total income of $5,878.00, all except the sum of $450.00 remained in the trusts, was reinvested and became a part of the corpus of the trust estates.

"4. The balance of $450.00 was paid to George H. Whiteley, Jr., and was invested by him for the children in forty shares of Empire Power Company preferred stock. The total purchase price of the forty shares was $2,727.06, the balance of the purchase price coming from savings accounts of the children.

"5. Of the forty shares of Empire Power Company preferred stock, ten shares were issued to and registered in the name of each child."

The foregoing facts plus the deed of trust (a copy of which, for convenient reference, is added to this Petition at page 19) are everything necessary to an understanding of the issues involved. They are all of the evidence and facts which the Board of Tax Appeals and the Circuit Court of Appeals had before them. They present the question, whether the income from the trusts is taxable to the grantor although no part of the income was used for the maintenance, education, or support of the grantor's minor children.

At the time these trusts were set up, the petitioner transferred and set over to the Trustee, to wit, The First National Bank of York, Pennsylvania, 1,000 shares of the

common stock of the Dentists' Supply Company of New York in each trust. The trust instrument provides that the income from the trust is to be paid to the donor as, if and when ordered in writing by him to do so during the minority of the particular child for whom the trust was set up, to be used solely and entirely by him for his or her support, maintenance, education and enjoyment. Each trust instrument further provides that if any income is accumulated and not distributed during the minority of the said minor child, such income shall be invested in securities if ordered and approved by the donor and become part of the corpus of the said trust. Upon each child attaining the age of twenty-one years, the Trustee shall distribute and pay over direct to the said child the income from said trust fund and any of the corpus, in such amounts and at such times as the donor in writing orders such distribution or distributions to be made. If the donor predeceases his wife, she is given the same rights as to ordering and directing distribution of the corpus and income of the said trusts. Following the death of the survivor of the donor and his wife, the Trustee is directed to make certain distributions to the said child for life, and upon his or her death, provision is made for the distribution of same to her children, or brothers, or sisters, if no children. Each of these trusts is irrevocable and under no conditions do the trust investments revert either in principal or interest to the donor, nor is there any power reserved in the said trusts in favor of the donor to receive the income therefrom except during the minority of each of the children, and if the donor elects in writing that the Trustee pay all or any of the income to him during the minority of any of the children, it must be used solely and entirely by him for his or her support, maintenance, education and enjoyment.

The total income of all four trusts for the calendar year 1935 was $5,878.00. Of this total income of $5,878.00, all except $450 remained in the trusts and was invested and became part of the corpus of the four trust estates. Only $450 was paid to the donor, and this was not expended by him for the support, maintenance, education and enjoyment of his four minor children, but was invested by him for the children in forty shares of Empire Power Company preferred stock. The total purchase price of the forty shares was $2,727.06, the balance of the purchase price coming from savings accounts of the four children. These shares were issued in lots of ten to each child, so that ten shares were actually registered in the name of each child. Accordingly, none of the income of the four trusts was used by the donor in 1935 for the support, maintenance, education, and enjoyment of the said four minor children.

Although the petitioner received none of the income of the four trusts for his personal use and none of it was used by him to discharge any legal obligation for the support of his minor children, the Commissioner taxed him with the full sum of $5,878.00 representing the total income of the four trusts. The action of the Commissioner was upheld by the Board of Tax Appeals although six members dissented and by the Circuit Court of Appeals.

Reasons Relied on for Allowance of Writ.

1. The decision of the court below is in conflict with the decision of the Circuit Court of Appeals for the 1st Circuit in *Higgins v. White,* 93 F. (2d) 357 (1937), a statement believed to be true as to the issue involved in this case although the Circuit Court of Appeals for the 1st Circuit reached a result opposite to its first decision upon another ground in 116 F. (2d) 312.

2. The decision of the court below is in conflict with several decisions of the Board of Tax Appeals referred to in the brief in support of this petition.

3. The court below clearly misconceived the decision of this court in *Helvering v. Horst*, 311 U. S. 112, in holding that case as "most conclusive" on the question involved; although the *Horst* case merely taxed the owner of a bond upon the money paid as interest on the bond in the year of its collection and although, the year before, the owner had clipped the coupon and given it as a gift to his son. The case, of course, has no application to a situation where the owner of a bond makes a gift of the bond itself, as well as the coupons attached to it—an obvious difference between the *Horst* case and the case at bar which escaped the court.

4. The court below has held that although a donor may have made an irrevocable gift of securities in trust, the income may nevertheless be taxable to him for no other reason than he gets a certain mental satisfaction out of having made the gift ;and finds justification for the conclusion in the decisions of this court particularly *Helvering v. Horst*—a doctrine so novel and far reaching that it ought to be reviewed by this court especially since it is charged with being its author. The exact language of the court is as follows:

> "In this case the settlor of these trusts by its terms could have received its income and applied it to the support of his minor children. He did not choose to do so, but left it to accumulate for them. He controlled the use of the money and had the same nonmaterial satisfaction as that of the taxpayer in the Horst case."

WHEREFORE, your petitioner prays that this petition be granted and that this court issue a Writ of Certiorari di-

rected to the Circuit Court of Appeals for the Third Circuit, commanding that Court to certify and to send to this court for its review a full and complete transcript of the record and all proceedings in the case entitled on its docket "No. 7620, George H. Whiteley, Jr., Petitioner, v. Commissioner of Internal Revenue, Respondent."

FREDERICK H. SPOTTS,
Attorney for Petitioner.

ROBERT C. FLUHRER,
PEPPER, BODINE, STOKES & SCHOCH,
Of Counsel.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I. Opinions of the Court Below.

The opinion of the Board of Tax Appeals is reported in 42 B. T. A. 402. It appears in the Record filed in the court below at page 67.

The opinion of the Circuit Court of Appeals for the 3d Circuit is not yet reported. It appears in the Record at page 86.

II. Jurisdiction.

The opinion of the Circuit Court of Appeals was filed May 29, 1941. The statute under which jurisdiction is invoked is section 240 (a) of the Judicial Code (28 U. S. C., section 347), as amended by the Act of February 13, 1925, 43 Stat. 938.

III. Statement of the Case.

A full statement of the case is presented under the heading "Summary Statement of Matter Involved" in the petition and, in the interest of brevity, is not repeated at this point. The basic question involved may be summarized as follows:

> Petitioner created four separate, irrevocable trusts, one for each of his four minor children. He reserved none of the income or corpus for his individual use and provided that the income from each trust be paid to him during the minority of each child as, if and when ordered by him in writing that it be paid to him, and if so paid, to be used solely for the support, maintenance, education and enjoyment of said minor. None

of the income was paid to him and used for such purpose or to meet any legal obligation of the petitioner. All of the income, with the exception of a small amount, remained in the trust and was reinvested and became a part of the corpus. Is the income from the trusts taxable to the petitioner?

IV. Specification of Error.

The court below erred in holding as taxable to the petitioner, income from securities which he had irrevocably given to a trustee in trust for his minor children, all of which was accumulated for the benefit of the children and none of which was in fact used for the maintenance, education or support of the children.

V. Argument.

None of the income of the four trusts for petitioner's minor children is taxable to him, because none of the income was used for the maintenance, education or support of the children.

The income totaled $5,878.00. All except $450.00 remained in the trusts, was reinvested and became a part of the corpus. The $450.00 was paid to the grantor and used by him to purchase certain shares of stock which were issued to and registered in the names of the children. No part of the income was used by the grantor in discharge of any legal obligation of the grantor. The Board of Tax Appeals (six members dissenting) held the income taxable to the grantor. The Circuit Court affirmed.

The trust is, of course, valid *as a trust*. If, in spite of its provisions, income realized and used by the trustee in accordance with its terms must nevertheless be taxed to the grantor of the trust, the authority to do so must be found

in the Revenue Act. We believe it cannot be denied that the Commissioner must rely either upon Section 22, which is the section dealing with gross income generally, or Section 167, which taxes income from trusts to the grantor under certain circumstances (26 U. S. C. A. § 22, 166 and 167).

We shall, therefore, consider Section 22 and Section 167. Section 22 in broad, general language provides for the taxation of income from whatever source it is derived. Under this section, as interpreted by this Court, it is clear that even the cases that have gone furthest in reaching income on the legal obligation theory, have taxed only income which has been actually paid and used to discharge a legal obligation of the taxpayer: *Douglas v. Willcuts,* 296 U. S. 1 (1935). It is clear from this case and all others decided under this section, that amounts paid in discharge of a legal obligation of the taxpayer are to be treated as income of the taxpayer. The basis of these decisions, as set forth in *Douglas v. Willcuts,* 296 U. S. 1, 9, is that, "The transaction is regarded as being the same in substance as if the money had been paid to the taxpayer and he had transmitted it to his creditor." Not only are the facts of these cases not similar to the facts of the instant case, because the money in this case was not used to discharge a legal obligation of the petitioner, but the basis of those decisions is clearly inapplicable to facts such as those in the case at bar. It must also be noted that the Court in *Douglas v. Willcuts* distinguishes the trust provisions of the Revenue Acts from Section 22 and makes it clear that they are set up to cover different types of situations. Neither section is a limitation or addition to the other, and each must stand on its own footing. We submit no case can be found where income has been held taxable to a taxpayer under Section 22 unless he was legally the owner

of the income or it was used to discharge his own legal obligation. That is not the case before this Court.

The Court below, however, felt that *Helvering v. Horst*, 311 U. S. 112 (1940), was an authority for assessing the tax against settlor under Section 22. In that case, the owner of negotiable bonds detached the interest coupons and delivered them to his son as a gift prior to their due date. The son collected them on the due date. The court held that the interest payments collected by the son were taxable income to the donor. We cannot see the possible relevancy of the *Horst* case to the facts in the case presented here. Obviously, if the donor in the *Horst* case had made a clear gift of the bonds themselves with the coupons attached, the result would have been different. Otherwise, it would no longer be possible to make a simple gift. Here, the gift is complete.

Yet the court below seizes upon certain language of Mr. Justice Stone in the *Horst* case, quotes it, finds it "most conclusive" of the question in this case, and pronounces the amazing doctrine that the income in this case is taxable to the grantor because of the "non-material satisfaction" which the grantor must have experienced in creating such a trust for his children. We find no fault with the quoted language when considered in connection with the facts involved in the *Horst* case, but the court below has taken the language in the abstract without relation to any particular set of facts and in effect holds that the Supreme Court of the United States has held that where a taxpayer makes a gift of securities and obtains some mental satisfaction out of making the gift, the income from the securities is taxable to him. We believe that this Court never intended to pronounce any such principle and that it has no more impor-

tant task to perform than to correct a Circuit Court which feels otherwise.

The opinion of the court below also refers to other powers which the grantor had in connection with the trusts. However, we believe it is clear that these powers are not such as will make the income from the trusts taxable to the grantor under the doctrine of *Helvering v. Clifford*, 309 U. S. 331 (1940). Essential elements in the *Clifford* case were the short term of the trust and the fact that the trust corpus reverted to the settlor at the end of the short term. The importance of these elements is clearly set forth in the Supreme Court's Opinion, on page 334:

> "We granted certiorari because of the importance to the revenue of the use of such short term trusts in the reduction of surtaxes."

The trusts in the instant case could not revert to the donor and each trust is to continue until the children of the grantor descending from the named child of the grantor become twenty-one years of age. During the years here in issue, the four children of the grantor were all minors, so that it obviously would be a considerable period of time before all the children of these minors would become twenty-one years old.

We now come to the relevancy of Section 167, which the court below merely stated was a question involved but did not decide because of its view of the *Horst* case. Our argument is, consequently, largely an attack upon the opinion of the Board in this respect. Under 167 (a), (2), if the trust income "may in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor," this part of the income of the trust will be

taxable to the grantor. The case of *Helvering v. Wood*, 309 U. S. 344 (1940), points out that the range of inquiry under Section 167 or like sections of the Revenue Acts is narrowly confined. The language is not broad and general, it is specific and clear. Do the facts of this case come within the language of Section 167? Obviously not, because "distributed to the grantor" as used in the statute clearly means distributed to him for his own use, and under no circumstances could the grantor avail himself of these funds for any personal use he chose.

Nothing would seem to be better settled than that income of a trust which may, in the discretion of the Trustee, be distributed for the maintenance and support of minor children of the grantor, *but which is in fact not so distributed*, is not taxable to the grantor. Even General Counsel Memorandum 18972, which was promulgated in 1937, so holds. This is the published opinion of the Chief Counsel for the Bureau of Internal Revenue. So far as we know, it is still in force. We can't understand why Respondent should publish one rule for the guidance of taxpayers and adopt another when it appears the taxpayer has done exactly as the ruling declared he should have done. This opinion is published in 1937-2 Cumulative Bulletin, p. 231, and reads in part (p. 233):

> "This office has reached the conclusion that in cases where the trust income, or at least part of it, might, in the discretion of the trustees, have been used to support the minor children of the grantor there should be taxed to the grantor only so much of the trust income as is actually distributed for the support and maintenance of the beneficiaries whom the grantor is legally obligated to support. The fact that the trust income may be distributed for the support of such per-

sons (but actually is not) does not make such income subject to distribution to the grantor within the meaning of section 167 of the Revenue Acts here involved.

"The opinion in *E. E. Black v. Commissioner*, promulgated by the Board of Tax Appeals on July 20, 1937 (36 B. T. A. 346), correctly states the rule."

* * * * * *

"Consequently, it is held that none of the income of the trusts in the instant case is taxable to the grantor under section 167 of the Revenue Acts of 1932 and 1934, since no part of the income was distributed or used for the support and maintenance of the beneficiaries."

As the dissenting opinion of the Board points out, all of the decisions except the anomalous case of *J. S. Pyeatt v. Commissioner*, 39 B. T. A. 774, are in accord with that ruling. Some of the authorities are:

Higgins v. White, 93 Fed. (2d) 357, (C. C. A. 1st, 1937), reversed on other grounds 116 F. (2d) 312 (1940);

Black v. Commissioner, 36 B. T. A. 346 (1937);

Berolzheimer v. Commissioner, 40 B. T. A. 645 (1939), reversed on other grounds 116 F. (2d) 628 (1940);

Hudson v. Jones, 22 Fed. Supp. 938 (1938);

Tiernan v. Commissioner, 37 B. T. A. 1048 (Appeal to C. C. A. 3d dismissed without opinion June 12, 1939);

Wolcott v. Commissioner, 42 B. T. A. 1151 (1940);

Chandler v. Commissioner, 41 B. T. A. 165, affirmed as to other issues 119 F. (2d) 623 (1941).

The opinion of the Board of Tax Appeals in the *Tiernan case,* 37 B. T. A. 1048, at page 1054, is particularly appropriate because of the similarity of its facts to the case at bar:

> "1. Although the four trusts established by Tiernan and by Wallace were for the benefit of their children in one case and of their children and wives in another, there was no power of revocation and no provision whereby under any circumstances either the corpus or the income could be revested in the grantor, hence there is no foundation for the application of section 166 or 167, Revenue Act of 1932. There is in each trust instrument a provision under which the trustee may in his discretion use the income for the education and support of the grantor's child, but it appears that in fact no such use was made of the income and that in fact the grantor was not relieved of any parental duty or obligation to maintain a child. The income was in fact accumulated and invested by the trustee. The wives in the taxable years in question actually received nothing from the trustees either by way of maintenance or otherwise. Thus the circumstances in evidence take the case entirely outside the scope of *Douglas v. Willcuts,* 296 U. S. 1, and similar cases, and bring it within *E. E. Black,* 36 B. T. A. 346, holding that the income of the trust is not under such circumstances taxable to the grantor."

It is equally well settled that a trustee, as such, does not have an adverse interest in the trust: *Reinecke v. Smith,* 289 U. S. 172 (1933).

There is no sound basis for failing to apply this rule to a factual situation such as that here presented, where the discretion is in the grantor instead of in some other person who does not have an adverse interest. A reading of

Section 167 (a), (2) would seem to dispose of this question. The Act specifically provides that where any part of the income "may, in the *discretion of the grantor* or of *any person not having a substantial adverse interest* in the disposition of such part of the income, be distributed to the grantor . . . then such part of the income of the trust shall be included in computing the net income of the grantor." (Italics supplied.) This section specifically states that income which may be "distributed to the grantor" in his discretion is given the same legal effect as income which may be distributed to him in the discretion of any other persons who do not have an adverse interest in the income. Both situations are clearly set forth as alternatives and have the same result for tax purposes. Here, no part of the income could be distributed to grantor, except for the support of his minor children. In some of the cases cited above, the settlor was also trustee, and therefore exercised his discretion in determining whether or not payments were to be made for the maintenance of his minor children, but this did not render the undistributed income taxable to the settlor. *Higgins v. White*, 93 Fed. (2d) 357 (1937); *Tiernan v. Commissioner*, 37 B. T. A. 1048 (1938); *Berolzheimer v. Commissioner*, 40 B. T. A. 645 (1939). We believe that the error of the Board of Tax Appeals in this case is caused by adding the provisions of Section 22 to those of Section 167, or vice versa. As the dissenting opinion of the Board clearly states:

> "That result [the holding of the majority] requires a linkage of the rationale of Douglas v. Willcuts, 296 U. S. 1, with the language of the cited section [167 (a), (2)], which, I think, is unjustifiable and barred by that section itself."

We believe that the opinions of this court demonstrate convincingly that the trust provisions and Section 22 are separate, distinct and independent bases of taxation. Their effect is not cumulative, complementary, coextensive, coterminus, or to limit each other. If the facts of any case come within either section 22 on the one hand, or section 167 on the other hand, the tax may be imposed—but for the tax to be imposed, the facts must come within one of these sections. When we apply this test to the facts of the instant case, we believe that it is clear that the income from these trusts cannot be taxed to the donor under the provisions of either section. The conclusion of the dissenting opinion of the Board is inescapable that, "the only possible basis, constitutionally and otherwise, for taxing the contested trust income to the grantor here, is under section 167 (a) (2) on the ground, implicitly barred by that section itself and inconsistent with decided cases, that he could have secured and used it to meet his legal obligation."

Conclusion.

The inclusion by the Respondent of the entire $5,878.00 of income from the four trusts in petitioner's individual income is without warrant in law. The agreed and stipulated facts, the decisions referred to above and in the dissenting opinion of the Board, and G. C. M. 18972 all support our contention. The trusts were valid and bona fide arrangements, irrevocably created under the laws of the Commonwealth of Pennsylvania. The income taxed to petitioner was not received by him, was not used by him in discharge of any legal obligation, and is therefore not chargeable to him. The contrary conclusion reached by the court below is based upon a principle of law so untenable that it should be

corrected, particularly because this Court is alleged to be the author of the principle.

Respectfully submitted,

FREDERICK H. SPOTTS,
Attorney for Petitioner.

ROBERT C. FLUHRER,
PEPPER, BODINE, STOKES & SCHOCH,
Of Counsel.

Appendix.

THIS INDENTURE OF TRUST made this 12th day of June, 1935, between GEORGE H. WHITELEY, residing at R. D. No. 9, York, Pennsylvania, hereinafter referred to as the Donor, and THE FIRST NATIONAL BANK OF YORK, Pennsylvania, hereinafter referred to as Trustee, this trust being known and designated as GEORGE H. WHITELEY TRUST No. 100,

WITNESSETH

WHEREAS, the Donor desires to assign, transfer and deliver to the Trustee, certain securities hereinafter described for the purpose of creating a voluntary living irrevocable trust, and

WHEREAS, the Trustee has agreed to accept said securities and to hold the same and the proceeds and income thereof upon the trusts hereby created.

NOW, THEREFORE, in consideration of the mutual covenants herein contained, and of other good and valuable considerations, the Donor has assigned, transferred and set over, and by these presents does assign, transfer and set over unto the said Trustee, its successors and assigns, all his right, title and interest in and to one thousand (1,000) shares of the no par value Common Stock of The Dentists' Supply Company of New York.

TO HAVE AND TO HOLD the said shares of stock, together with additional securities, money or other property which may be transferred by the said Donor or others, unto the said Trustee, its successors and assigns, IN TRUST NEVERTHELESS, for the following purposes and uses and subject to

the terms, conditions, powers and engagements hereinafter set forth, to-wit:

To pay the income from this trust to the Donor, as, if and when ordered in writing by him to do so, during the minority of his daughter, Virginia Whiteley, to be used solely and entirely by him for her support, maintenance, education and enjoyment. If any income is accumulated and not distributed during the minority of the said Virginia Whiteley, such income shall be invested in securities if ordered and approved by the Donor, not limited to investments that are legal for trust funds in the State of Pennsylvania, and become part of the corpus of this trust. Upon her attaining the age of twenty-one years, the Trustee shall distribute and pay over direct to the said Virginia Whiteley, the income from this trust fund and any of the corpus in such amounts and at such times as the Donor in writing orders such distribution or distributions to be made.

If Purdon Smith Whiteley, wife of the Donor, survives the Donor, she shall succeed to and have the same rights as to ordering and directing distribution of the corpus and income of this trust and investment of undistributed income, as hereinabove provided for the Donor.

Upon the death of the survivor of the Donor and his wife, Purdon Smith Whiteley, the Trustee is hereby directed and authorized to distribute and pay unto Virginia Whiteley, the daughter of the Donor, in quarterly installments, the income from this trust, and upon the death of Virginia Whiteley, if she dies without a child or children surviving her, the corpus of this trust fund shall be divided, share and share alike, and added to the similar trusts created even date herewith in favor of George H. Whiteley, III, Morgan S. Whiteley, and Purdon B. Whiteley, and be

subject to the terms thereof. If Virginia Whiteley dies leaving a child or children to survive her, the corpus of this trust shall remain intact and the income therefrom distributed, share and share alike, among such surviving children, during their respective minorities, if necessary and required for their support, maintenance or education, and upon each of said children attaining the age of twenty-one years, the Trustee shall transfer and set over to such child as he or she attains the age of twenty-one years, his or her equal share in the corpus of this trust including accumulated income, with the right of survivorship among such surviving children in the event of the death of any prior to attaining the age of twenty-one years, and in the event of all of such surviving children dying before attaining the age of twenty-one years, the corpus of this trust fund shall be distributed equally and added to the similar trusts created even date herewith for my other children, George H. Whiteley, III, Morgan S. Whiteley, and Purdon B. Whiteley, and be subject to the terms of their trusts.

Each and every beneficiary under this trust is hereby restrained from and are and shall be without right, power and authority to sell, transfer, pledge, mortgage, hypothecate, alienate, anticipate, or in any other manner affect or impair his, her or their beneficial and legal rights, titles, interests, claims and estates in and to the income and/or principal of this trust during the entire term hereof, nor shall the rights, titles, interests and estates of any beneficiary hereunder be subject to the rights or claims of creditors of any beneficiary nor subject nor liable to any process of law or court, and all of the income and/or principal under this trust shall be transferable, payable and deliverable only, solely, exclusively and personally to the above designated beneficiaries hereunder at the time entitled to take the same

under the terms of this trust, and the personal receipt of the designated beneficiary hereunder shall be a condition precedent to the payment or delivery of the same by said Trustee to each such beneficiary.

During the life of the Donor, and if his wife survives him, during her life, all investments and reinvestments shall be made only by and with the approval of the Donor herein and after his death with the approval of his wife, Purdon Smith Whiteley, if she survives him, and when thus made the Trustee hereunder shall be without liability or responsibility to any person whatsoever.

The said Trustee shall have power, in addition to and not in limitation of any authority given it by law, to exercise any of the following powers, to wit:

To retain, without liability, any investments in the form in which they may be at the time of the creation of this trust or when added to this trust, whether legal investments for trust funds under the laws of Pennsylvania or not.

To invest and reinvest, alter, vary, and change investments and reinvestments from time to time, not being confined to what are known as Legal Investments, any Statute to the contrary notwithstanding,—subject, however, to the restriction that the original one thousand (1,000) shares of The Dentists' Supply Company of New York deposited with the Trustee shall not be sold or exchanged except and unless said Company is reorganized or merged and in the opinion of the Trustee it is advisable and expedient to accept other stock and/or securities in exchange for said one thousand (1,000) shares of the no par Common Stock of The Dentists' Supply Company of New York, or the condition of said Company becomes such that the Trustee deems it advisable to sell said shares of stock, subject to the consent of

the Donor during his lifetime and his wife during her lifetime if she survives him.

To purchase investments at a premium and to charge the premium over to principal or income or partly to principal and partly to income, as it shall deem best.

To sell any securities or other personal property except as hereinabove provided, which may at any time form part of this trust for such prices, upon such terms, in such way and manner, and for such interests and estates as may be deemed wise, and to make good transfers and assignments therefor to the purchaser or purchasers thereof without any obligation on the latter to see to or be responsible for the application of the purchase money.

To exercise any option to subscribe for new stocks or bonds or certificates or other instruments in the nature thereof which may be given to it as the holder of any stocks or bonds or certificates or other instruments in the nature thereof belonging to this trust estate.

To join in any plan or lease, mortgage, consolidation, exchange, reorganization or foreclosure of any corporation in which said Trustee as such may hold stocks or bonds or other securities, and to deposit such stocks, bonds or other securities under such plan, and likewise to participate in the liquidation, reorganization, consolidation, incorporation, or to the financial readjustment of any corporation or business in which the trust estate is or shall be financially interested.

To determine what expenses and other items shall be charged against principal and what against income.

To compromise, arbitrate, abandon or otherwise adjust claims in favor or against the trust estate.

To borrow money for the benefit of the trust estate and secure the same by hypothecating any of the securities included in this trust.

To hold any or all securities or other property in bearer form, in its own name, or in the name of some other person, partnership, or corporation, or in the name of a duly appointed nominee, with or without disclosing the fiduciary relation.

To apply stock dividends and any other extraordinary non-cash dividends to income or principal of the trust estate or to apportion the same between income or principal in its absolute discretion and the decision of the Trustee shall be final and conclusive and binding upon all persons interested in the trust estate.

To execute and deliver assignments, powers of attorney for the transfer of shares of stock, contracts, bills of sale, notes, and any and all other instruments in writing required for the administration of this trust.

To make distributions in cash or in kind or partly in cash and partly in kind at valuations to be determined by the Trustee.

From the date of death of the survivor of the Donor, George H. Whiteley, and his wife, Purdon Smith Whiteley, the Trustee is authorized, directed and empowered to distribute and use any part of the corpus and/or income of this trust fund as in its opinion, in the exercise of its sole and uncontrolled judgment, may be proper for the comfort, education, maintenance and support of any beneficiary, or that might be necessary as the result of sickness or emergency. The Donor hereby exonerates the Trustee of and from all liability or responsibility for or by reason of any payments the Trustee may make out of the corpus or income of this trust for the purposes above mentioned or for the application thereof, its decision to be final and conclusive.

POWERS OF DONOR

First: To vote at corporate meetings in person or by proxy, with or without power of substitution, all shares of stock constituting part of this trust. The wife of the Donor, shall succeed to this power and right during her lifetime, if she survives the Donor. After the decease of the survivor of the Donor and his wife, the Trustee shall exercise this right and power.

Second: The Donor reserves the right to add to the investments, securities, or other property, real or personal, to the corpus of the fund herein created as he may in his discretion, from time to time deem advisable, the same to be thereafter held subject to the terms and conditions hereof.

IN WITNESS WHEREOF, the said parties have hereunto set their respective hands and seals the day and year first above written.

Witness:

.....

..... (SEAL)

THE FIRST NATIONAL BANK
OF YORK, PA.

By:.....
President

ATTEST:

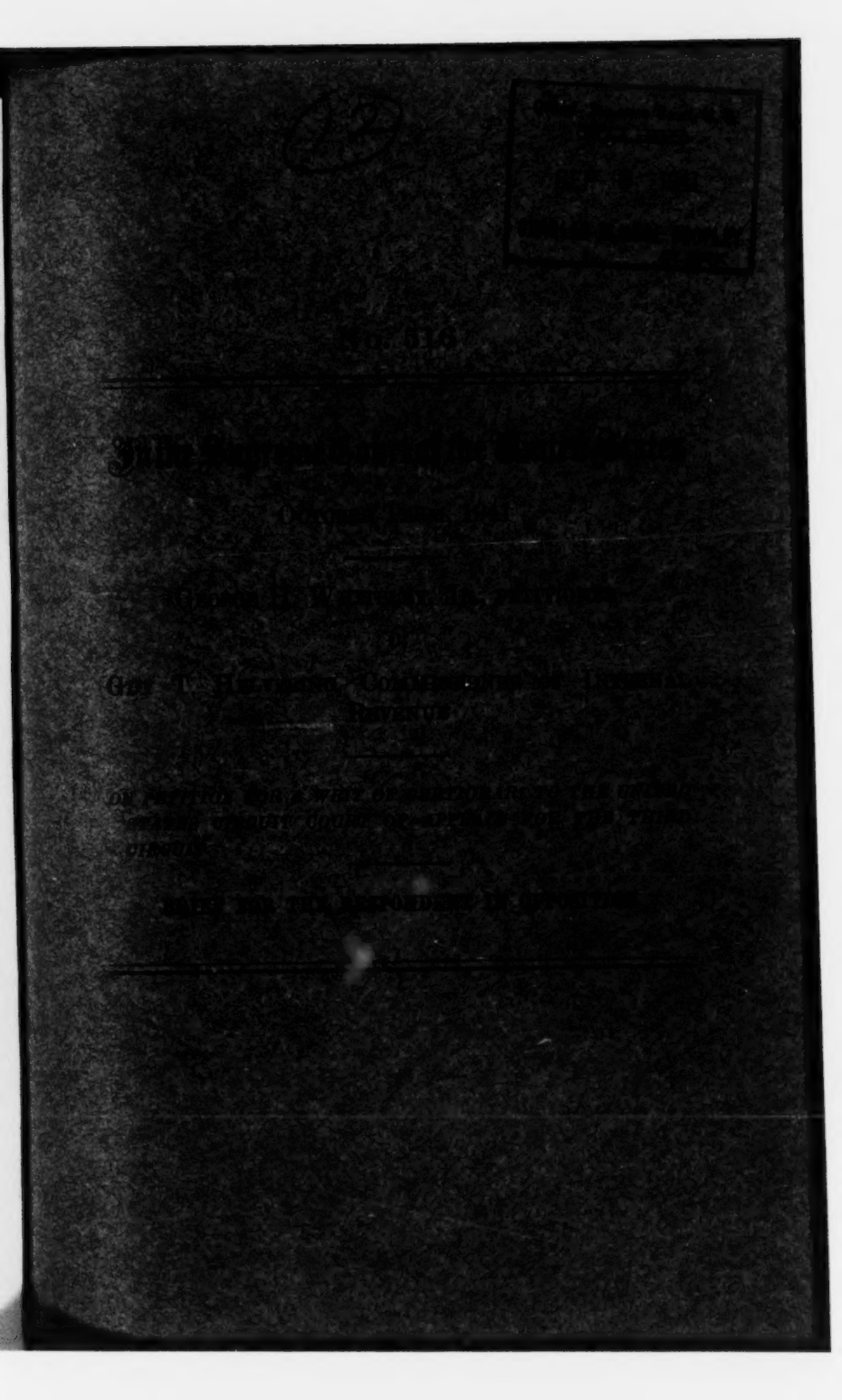
.....
Secretary

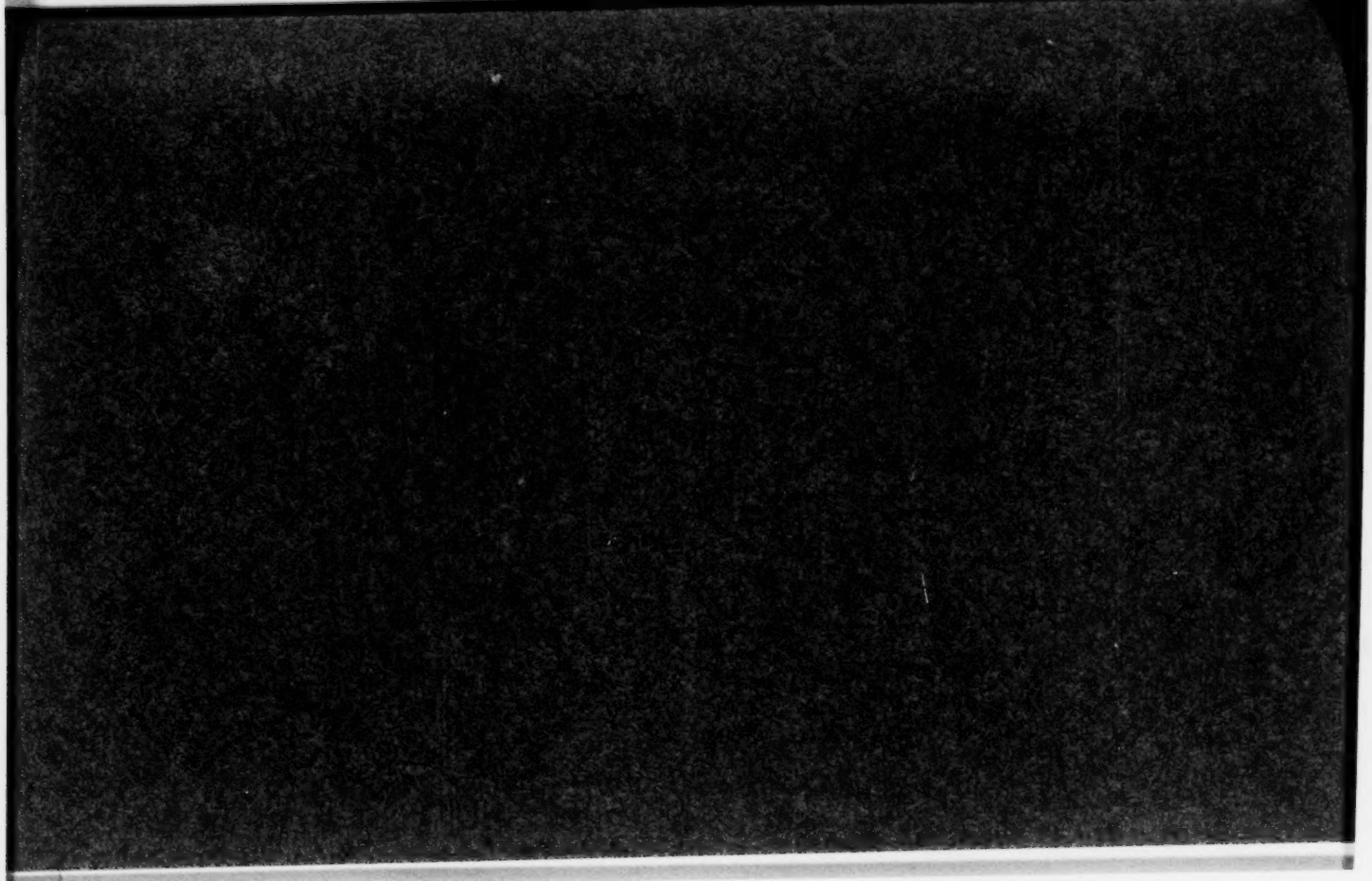
STATE OF PENNSYLVANIA }
COUNTY OF YORK } ss:

Before me, a Notary Public in and for said State and County, personally appeared George H. Whiteley, who in due form of law, acknowledged the foregoing Indenture of Trust to be his voluntary act and deed and desired that same be recorded as such according to law.

WITNESS my hand and notarial seal this day of June, A. D. 1935.

.....
Notary Public





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411598—41

In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 516

GEORGE H. WHITELEY, JR., PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion and dissenting opinion in the Board of Tax Appeals (R. 67–84) are reported in 42 B. T. A. 402. The opinion of the Circuit Court of Appeals (R. 86–92) is reported in 120 F. (2d) 782.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered May 29, 1941 (R. 92). The petition for writ of certiorari was filed August 16, 1941.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer created trusts for the benefit of his children, all of whom were minors during the taxable year, reserving the right to order the trustee to pay the income to himself to be used for their support. During taxpayer's life, investments of trust funds were to be made only with his approval; he also reserved the right to vote all shares of stock held in trust. Upon attaining majority, each child was to get the undistributed income and any of the corpus in such amounts and at such times as ordered by the taxpayer. Was the taxpayer accountable under Sections 22 (a) or 167 of the Revenue Act of 1934 for the 1935 income of the trusts which was invested for the benefit of the children?

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra,* pp. 8–12.

STATEMENT

The Board of Tax Appeals found the following facts:

On June 12, 1935, the taxpayer created an irrevocable trust for each one of his four children, naming the First National Bank of York, Pennsyl-

vania, trustee. The terms of the trusts were identical. The one created for the benefit of his minor daughter, Virginia, provided for the payment of the income of the trust "to the Donor, as, if and when ordered in writing by him to do so, during the minority of his daughter, Virginia Whiteley, to be used solely and entirely by him for her support, maintenance, education, and enjoyment." Any income not distributed was to be invested in securities "if ordered and approved by the Donor." After the beneficiary attained the age of 21, she was entitled to receive income and corpus "in such amounts and at such times as the Donor in writing orders such distribution or distributions to be made" (R. 72–73).

During 1935 the income of the four trusts was $5,878, all of which, except $450, was invested and became a part of the corpus of the trust. The $450 was paid to the taxpayer and was invested by him for the children in 40 shares of preferred stock of the Empire Power Company. Ten shares of the stock were issued to and registered in the name of each child (R. 73).

The Commissioner ruled that the entire item of $5,878 received by the four trusts must be included in the taxpayer's gross income. The Board of Tax Appeals sustained the Commissioner and the court below affirmed the decision of the Board.

ARGUMENT

This case does not present a conflict, and it was correctly decided in accordance with principles approved by this Court.

1. The grantor retained the power to distribute the income for the support of his minor children, or to direct its accumulation for their benefit to be paid to them at such time and in such manner as he might determine. He reserved also substantial control over the corpus. It seems quite plain that such an attempt to deflect income to members of the family group while at the same time retaining control over its source can not relieve the taxpayer of liability. *Helvering* v. *Horst,* 311 U. S. 112; *Helvering* v. *Eubank,* 311 U. S. 122; *Harrison* v. *Schaffner,* 312 U. S. 579; *Helvering* v. *Clifford,* 309 U. S. 331; *Hormel* v. *Helvering,* 312 U. S. 552; *Helvering* v. *Fuller,* 310 U. S. 69, 76.

2. Although the foregoing result was reached by the court below upon the basis of Section 22 (a) of the Revenue Act of 1934, the decision is also supportable under Section 167 (a) (2), as was held by the Board of Tax Appeals. For, under *Helvering* v. *Schweitzer,* 296 U. S. 551 and related cases,[1] trust income devoted to the maintenance of the grantor's minor children is treated as though it were paid directly to the grantor. Therefore, since the grantor could have required the income

[1] *Helvering* v. *Stokes,* 296 U. S. 551; *Helvering* v. *Coxey,* 297 U. S. 694; cf. *Douglas* v. *Willcuts,* 296 U. S. 1, 9.

to be so distributed, Section 167 (a) (2) is applicable.

3. The taxpayer's reference (Br. 12–13) to an unofficial ruling (G. C. M. 18972, 1937–2 Cum. Bull. 231, 233) in support of his position must be considered in the light of the Treasury Regulations themselves which, as originally adopted,[2] and as amended (Appendix, *infra*), are in accord with our interpretation of the statute.

---

[2] Treasury Regulations 86, promulgated under the Revenue Act of 1934:

"ART. 167–1. *Trusts in the income of which the grantor retains an interest.*— * * *

"(*b*) *Test of taxability to the grantor.*—The test of the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether the grantor has failed to divest himself, permanently and definitively, of every right which might, by any possibility, enable him to have the income, at some time, distributed to him, actually or constructively. Such a distribution to the grantor occurs if the income is paid to him or to another according to the grantor's direction or if, though paid to another pursuant to the terms of the trust, the benefit of the income inures to the grantor. The income so inures if it is or may be applied in satisfaction of a legal obligation of the grantor. * * *

* * * * *

"If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

* * * * *

"(4) whether, if such distribution results in the inuring of benefits to the grantor from the application of the income in satisfaction of his legal obligation, such obligation is to pay a debt, to support dependents, to pay alimony, to furnish maintenance, and support or otherwise:"

4. *Higgins* v. *White,* 93 F. (2d) 357 (C. C. A. 1st), does not, as asserted by petitioner (Pet. 4), present a conflict between the circuits. Not only does it involve a materially different factual situation, but the decision itself is now of doubtful authority in the First Circuit. Upon a second appeal in that case, judgment was entered for the Government upon a different theory, and the court expressed considerable doubt as to its prior ruling indicating that it would not then be reexamined only because it had become the law of the case. *White* v. *Higgins,* 116 F. (2d) 312 (C. C. A. 1st).

CONCLUSION

The decision below is correct. There is no conflict with any decision of any Circuit Court of Appeals. The petition should be denied.

Respectfully submitted.

CHARLES FAHY,
Acting Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
ARNOLD RAUM,
HELEN R. CARLOSS,
L. W. POST,
Special Assistants to the Attorney General.

SEPTEMBER 1941.

APPENDIX

Revenue Act of 1934, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(U. S. C., Title 26, Sec. 22.)

* * * * *

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial

adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question". (U. S. C., Title 26, Sec. 167.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

* * * * *

ART. 167–1 [as amended by T. D. 4759, 1937–2 Cum. Bull. 117, 118, and T. D. 4860, 1938–2 Cum. Bull. 184]. *Trusts in the income of which the grantor retains an inter-*

est.—(*a*) *Scope.*—Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(*b*) *Test of taxability to the grantor.*—The test prescribed by the Act as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, both permanently and definitively, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(4) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) when the trust was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's legal obligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor.

If the grantor strips himself permanently and definitively of every such interest retained by him, the income of the trust realized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

(*c*) *Income and deductions.*—If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled had such income been distributable currently to him.

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IN THE

Supreme Court of the United States

October Term, 1941.

No. 516.

GEORGE H. WHITELEY, JR.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

SUPPLEMENT TO PETITIONER'S BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

FREDERICK H. SPOTTS,
Attorney for Petitioner.

ROBERT C. FLUHRER,
PEPPER, BODINE, STOKES & SCHOCH,
Of Counsel.

International, 236 Chestnut St., Philadelphia

Petitioner begs leave to call the attention of the Court to the decision of the United States Board of Tax Appeals in the case of *Frederick Ayer v. Commissioner*, Docket No. 93019, 45 B. T. A. , No. 26, promulgated September 18, 1941.

The facts of the case appear to be on all fours with the case of the petitioner, *George H. Whiteley, Jr. v. Commissioner*, but the Board reached a result opposite to that reached in the *Whiteley* case.

The majority and the dissenting opinions in both the *Whiteley* and the *Ayer* case, when compared with each other, illustrate the confusion and uncertainty which exist in the Board with respect to whether the income of a trust like the one in the case at Bar is taxable to the settlor of the trust; and, if so, whether under Section 166, Section 167, or Section 22 (a).

It would seem that the petitioner lost his case before the Board of Tax Appeals merely because it happened to be decided by the Board on July 23, 1940, instead of September 18, 1941, at which time the majority of the Board had changed its mind.

We believe that the conflict in decision in the Board itself between the *Whiteley* and the *Ayer* case is as serious a matter as a conflict between two Circuits and is a sound reason for the allowance of the Petition for the Writ of Certiorari in this case.

Respectfully submitted,

FREDERICK H. SPOTTS,
Attorney for Petitioner.